Brussels, 8 May 2008

BACKGROUND[1]

ECONOMIC and FINANCIAL AFFAIRS COUNCIL

Wednesday 14 May in Brussels

The Council will be preceded as usual by a meeting of the ***eurogroup****, on Tuesday starting at 17.00.*

On Wednesday at 9.00, ministers will meet their counterparts from the candidate countries in order to review their pre-accession economic programmes.

The Council, starting at 10.00, will set out policy and procedures to be followed in improving the EU's arrangements for ***financial supervision and financial stability*** *and will take stock of initiatives to better combat* ***VAT fraud****. And following on from discussions in March, the Commission will provide an informal oral interim report on implementation of the directive on* ***savings taxation****.*

Financial education*, investment in the* ***Western Balkans****, the quality of* ***public finances*** *and development of the EU's* ***customs union*** *are amongst the other items on the Council's agenda.*

Over lunch, the president of the eurogroup will report on deliberations of the previous evening, and ministers will discuss future work on VAT rates.

Press conferences:

- after the eurogroup meeting *(Tuesday, as from 20.00)*;
- at the end of the Council, before lunch (*Wednesday, as from 13.00*).

Press conferences and public events can be followed by video streaming:
http://www.consilium.europa.eu/videostreaming

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[1] This note has been drawn up under the responsibility of the press office

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The quality of public finances: expenditure on social transfers and education

The Council is due to adopt conclusions, following on from discussion by ministers at an informal meeting at Brdo, near Ljubljana, on 4 and 5 April 2008, on the efficiency and effectiveness of social spending (*doc. 8429/08*).

Work is ongoing with a view to enabling the member states to improve the quality of their public finances. The Council adopted conclusions in June 2007 following discussion at an informal meeting in Berlin in April, and again in October 2007 after an informal meeting in Porto in September.

This time, the draft conclusions look at the efficiency of expenditure on social transfers and education. Member states spend between 13% and 33% of their gross domestic product on social expenditures.

The draft conclusions note that member states' experiences help to identify possible directions for spending reforms. Whilst emphasising that there is no one-size-fits-all solution, they identify a number of general features that may support reforms of social protection systems. They call on the economic policy committee and the Commission to step up efforts to improve the measurement and analysis of the quality of public finances and their impact on growth.

The Council is due to return to the issue in the first half of next year with an analysis of trends in the composition of public expenditures.

Western Balkans investment framework

The Council is due to adopt conclusions, following on from discussion by ministers at an informal meeting at Brdo, near Ljubljana, on 4 and 5 April, on the coordination and strengthening of support for investment in the Western Balkans (*doc. 8506/08*).

The draft conclusions note the progress made by Western Balkan countries in the transition and integration of their economies, and lay the ground for the further anchoring of macro-economic growth and stability in the region, underpinned by private and public investment. They look in particular at cooperation with the European Bank for Reconstruction and Development, the European Investment Bank (EIB) and the Council of Europe Development Bank.

The European Council in June 2006 welcomed the Commission's intention to extend and intensify its cooperation in the Western Balkans with the EIB and other international financial institutions (IFIs). The Commission has agreed with the IFIs to create an investment framework in two steps, as set out in a communication issued on 5 April.

The first step focuses on infrastructure, with the creation by the end of this year of:

- two sources of grants for investment projects. The first, an infrastructure project facility (IPF), uses Commission resources to finance technical assistance, leveraging loans from the IFIs. Decisions will be taken by a steering committee, meeting for the first time in June, chaired by the Commission with representatives of the IFIs. The second, a complementary grant financing mechanism (CGFM), uses grants from the IFIs, other multilateral and bilateral donors, as well as the Commission;
- a lending facility coordinated by the IFIs. With EUR 1 billion, the facility will provide financing for priority projects using grants from the IPF and/or the CGFM.

During the second step, to be completed by 2010, the scope of cooperation will be enlarged to other areas of development, such as SMEs. The Commission, IFIs and bilateral donors will endeavour to improve the efficiency, leverage and visibility of different instruments used by the EU in the region. A steering group, chaired by the Commission, with representatives of the IFIs and possibly also member states actively active in the region, will work on implementation of the framework.

Financial supervision and financial stability

The Council is due to adopt conclusions reflecting the outcome of discussion by ministers at an informal meeting at Brdo, near Ljubljana, on 4 and 5 April, on financial market supervision and financial stability arrangements.

The conclusions are presented in two separate documents, one dealing with policy (*doc. 8515/08*), the other presenting three updated roadmaps (*doc. 9056/08*).

The Council will adopt the conclusions in line with a request from the European Council, at its meeting on 13 and 14 March 2008, which called for action to further improve supervisory and regulatory arrangements at national, EU and global level.

This covers the convergence of key supervisory rules, standards and reporting; the role of "home" and "host" authorities, appropriately reflecting their competences and responsibilities, including the exchange of information; the role of "colleges of supervisors"; the improved functioning of supervisory committees; and consideration of the inclusion of an EU dimension in the mandates of national supervisors.

The Council will also approve an update of three roadmaps, on the so-called Lamfalussy process for financial services and regulation and supervision, financial stability arrangements and actions taken in response to the recent turbulence on financial markets. The proposed update sets out the steps to be followed in developing the EU framework for financial market supervision – in particular as regards EU committees of supervisors and the supervision of EU-wide financial groups – as well as EU arrangements for financial stability.

At Brdo in April, ministers and central bank governors agreed to sign an updated memorandum of understanding on cross-border cooperation in financial crisis management[2].

Financial education

The Council will take note of a communication from the Commission on financial education (*doc. 5250/08*), and is due to adopt conclusions (*doc. 8516/08*).

The Commission's communication highlights the life-long importance of financial education. Consumer information and protection are a key element in EU financial services legislation.

Improved understanding of financial products and financial concepts and the development of financial literacy skills enable individuals to be better aware of risks and opportunities, and to make informed decisions in their choice of financial services.

2 The previous memorandum of understanding dates from May 2005.

However, numerous international surveys have demonstrated amongst consumers a generally low level of understanding of financial matters and basic economics, whilst innovation and globalisation are increasing the range and complexity of services on offer. The current difficulties in the United States sub-prime mortgage market, where many consumers have taken on mortgages going beyond their means, illustrates the problem.

The draft conclusions acknowledge the need for establishing instruments at EU level, including for the exchange of best practices, for a more effective provision of financial education involving both the public and private sectors.

Mortgage credits

The Council is due to adopt conclusions on the integration of EU mortgage credit markets (*doc. 9031/1/08 REV 1*), on the basis of a white paper from the Commission (*5128/08*).

The white paper, issued in December following a review of EU residential mortgage markets, presents measures that could be applied in order to improve the efficiency and competitiveness of the industry. The review showed that EU markets in this sector are far from integrated, and that obstacles exist that restrict cross-border activity.

Although it takes account of recent developments on financial markets, the white paper does not attempt to respond directly to problems originating on the United States sub-prime market, which were more comprehensive addressed by the Council at its meeting on 9 October.

The measures presented would aim at increasing competition and choice in the market by facilitating the cross-border supply of mortgage credit, improving the diversity of financial products, improving consumer confidence and facilitating customer "mobility" in the choice of financial products.

The draft conclusions encourage the Commission to continue assessing the costs and benefits of the various policy options, including as regards possible legislation.

Dialogues with third countries on economic issues

The Commission will brief the Council on recent developments in its dialogues with a number of third countries.

The Council will discuss preparations for the EU-US summit as regards economic and financial issues, as well as preparations for the Asia-Europe (ASEM) finance ministers meeting, at Jeju Island, Korea, on 16 June.

Combating VAT fraud

The Council will be called on to adopt conclusions on the issue of combating value-added tax (VAT) fraud, on the basis of a communication from the Commission (*doc. 6859/08 + ADD 1*).

And the Commission will brief the Council on the preparation of measures (so-called conventional measures, see below) to better combat VAT fraud.

VAT fraud costs the EU more than EUR 100 billion every year. Free circulation of goods within the internal market since 1993 has accentuated the need for strengthened cooperation amongst member states in fighting both VAT fraud and other forms of tax fraud.

The VAT system is vulnerable, for instance, to a practice known as "carousel" fraud, where goods are traded so as to enable fraudulent businesses to deduct input VAT whilst the supplier deliberately does not pay the VAT that is due.

In November 2006, the Council agreed to establish an anti-fraud strategy at EU level in order to complement national efforts, especially with regard to VAT fraud.

In June 2007, it requested the Commission to present legislative proposals aimed at reinforcing the VAT system. Whilst favouring in this way so-called conventional measures for tackling VAT fraud, it also asked the Commission to analyse the possible effects of more far-reaching measures that would involve modifying the VAT system.

As regards the more far-reaching measures, it asked the Commission to examine two possibilities:

- taxation of intra-Community transactions;
- the optional use by member states of a generalised reversal of tax liability (the so-called reverse-charge system) for supplies with a value exceeding EUR 5000.

Under a reverse-charge system, which is already used in specific limited cases by some member states, the VAT liability for transactions between companies is shifted from the company providing the supply to the company receiving the supply. In order to assess the potential of a generalised reverse-charge system, the Council also asked the Commission to examine the possibility of running a pilot project in one member state.

In a communication approved in February, the Commission examined the potential for both types of far-reaching measures.

The predominant view amongst member states is that priority should be given to work on conventional measures, and that fundamental changes to the VAT system should only be considered if conventional measures fail to be efficient in tackling fraud. And although certain delegations want the Commission to present rapidly a proposal for a pilot project, many have reservations on the idea of a generalised reverse-charge system.

At its meeting on 4 March, the Council held an initial debate on these issues.

Taxation of savings

At its meeting on 4 March, the Council asked the Commission to accelerate preparation of a report (scheduled three years after entry into force) on implementation of directive 2003/48/EC on the taxation of savings income. The Commission will present an informal oral interim report on the functioning of the directive.

Savings tax measures are currently applied within the EU under directive 2003/48/EC, as well as in five third countries (Andorra, Liechtenstein, Monaco, San Marino and Switzerland) and in ten member state territories (the Channel Islands, the Isle of Man and the dependent and associated territories of the Caribbean) under savings tax agreements.

At its March meeting, the Commission briefed the Council on progress made in contacts with other third countries and territories with a view to concluding a further set of savings tax agreements.

Directive 2003/48/EC requires member states to exchange information on interest paid in one member state to individual savers resident in another member state, so as to allow the interest to be taxed in the member state of tax residence. The directive entered into force on 1 July 2005.

For a transitional period[3], Belgium, Luxembourg and Austria may instead impose a withholding tax on interest paid to individual savers resident in other member states[4]. The tax rate is 15% for the first three years of the directive's implementation, 20% from 1 July 2008 to 30 June 2011 and 35% thereafter. The three member states must transfer 75% of the tax revenue to the member state of tax residence, retaining 25% to cover their own administrative costs. The directive contains provisions to eliminate any double taxation.

The scope of the directive is limited to individuals, to the exclusion of companies.

It covers the taxation of savings income in the form of interest payments, including income from deposit accounts, government securities and corporate bonds, as well as collective undertakings that invest more than 40% of their assets in debt securities (more than 25% as from 2011).

A Commission working document outlines the main issues raised in its review of the directive, as well as possible ways of refining the directive's coverage.

The main issues raised in the Commission's review include:

- whether or not to extend the directive's scope to cover legal persons;
- possible additional obligations for non-transparent entities and arrangements;
- an improved definition of investment funds and vehicles;
- whether to extend the directive's scope to cover share dividends, capital gains and income from life insurance and pension schemes.

The Council will examine these issues in greater detail once it has received the Commission's full report.

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3 The length of the transitional period depends on Andorra, Liechtenstein, Monaco, San Marino, Switzerland and the United States being committed to exchange of information upon request as defined in a 2002 OECD model agreement

4 Although individual savers may request that no tax be withheld and information on interest received instead be communicated to the member state of tax residence.

Customs union

The Council will hold an exchange of views on the further development of the EU's customs union, on the basis of a communication from the Commission. It is due to adopt conclusions.

The Commission has undertaken a review of the customs union, after nearly 40 years' existence, and has discussed its findings with member states' customs administrations. The customs union entered into force on 1 July 1968.

In its communication, the Commission sets out a strategy aimed at improving working methods and reinforcing coordination. It highlights a rapidly changing environment, with evolving production and consumption patterns, increasing international trade and global threats such as terrorism, organised crime, climate change and new hazards such as trade in dangerous goods. And it identifies the role to be played by customs authorities in ensuring a balance between the protection of society and facilitating trade through control of the import and export of goods, both at the EU's external borders and within the EU.

Some improvements in the customs sector are already being applied. The European Parliament and the Council earlier this year adopted a regulation aimed at modernising the EU's customs code, as well as a decision aimed at creating a paperless environment for customs and trade. And the Commission has presented a proposal for a regulation aimed at streamlining and improving information technology systems and enhancing capacity in combating fraud.

The draft Council conclusions call for further work to focus on increasing competitiveness by facilitating legitimate trade, on the enhancement of safety and security, notably in combating counterfeiting and piracy, and on the capacity to react rapidly to crises, as well as the protection of the financial interests of the EU and the member states and the fight against fraud, and the enhancement of cooperation with economic operators, other governmental authorities, international organisations and third countries.

EU budget - Preliminary draft budget for 2009

The Commission will present its preliminary draft for the EU's general budget for 2009, with a view to the Council's first reading scheduled for 17 July.

At its meeting on 4 March, the Council approved guidelines setting out principles for preparation of the 2009 budget (*doc. 6704/08*).